

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF TENNESSEE

In re

ROBERT W. MILLER and
JANET LEIGH MILLER,

Debtors.

No. 96-21827
Chapter 7

ROBERT TWADDLE d/b/a
WET PETS,

Plaintiff,

vs.

Adv. Pro. No. 96-2078

ROBERT W. MILLER,

Defendant.

M E M O R A N D U M

APPEARANCES :

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Bristol, Tennessee 37620
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MARCIA PHILLIPS PARSONS
UNITED STATES BANKRUPTCY JUDGE

This 11 U.S.C. § 523(a)(2)(A) and (B) action is before the court on the plaintiff's motion for summary judgment wherein he asserts that his prepetition state court default judgment against the debtor based on fraud is entitled to collateral estoppel effect in this dischargeability proceeding. Because the requisite elements of 11 U.S.C. § 523(a)(2)(A) are established by the judgment, default judgments are given collateral estoppel effect in Tennessee, and the Sixth Circuit Court of Appeals recently concluded that state court default judgments must be given preclusive effect in bankruptcy dischargeability actions if the state in which the judgment were rendered would give such effect, see *Bay Area Factors v. Calvert (In re Calvert)*, 105 F.3d 315 (6th Cir. 1997); the motion for summary judgment will be granted. This is a core proceeding. 28 U.S.C. § 157(b)(2)(I).

I.

Debtor Robert W. Miller, along with his wife, codebtor Janet Leigh Miller, filed a joint petition for relief under chapter 7 of the Bankruptcy Code on August 16, 1996. One month preceding that bankruptcy filing, the plaintiff in this adversary proceeding, Robert Twaddle d/b/a Wet Pets, obtained a final judgment against the debtor in a Tennessee state court lawsuit,

Caldwell Supply Co., Inc., et al., v. Robert Twaddle d/b/a Wet Pets, Washington Chancery Civil Action No. 30542. That lawsuit was originally brought against the plaintiff herein by certain creditors of the debtor's previous business venture, the assets of which the plaintiff purchased in a bulk sale from the debtor in April 1995. In response to the state court complaint, plaintiff filed a third-party complaint against the debtor and a motion for summary judgment thereon.

On May 31, 1996, an order was entered by the state court chancellor granting the plaintiff's motion for summary judgment, *nunc pro tunc* as of May 9, 1995.¹ That summary judgment order recites as follows:

This matter having been heard by the Court on the 9th day of May, 1996, on Motion of the Defendant Third Party Plaintiff Robert Twaddle for a Summary Judgment pursuant to Rule 56 of the Tennessee Rules of Civil Procedure against the Third Party Defendant Robert W. Miller; and the Court, having considered the pleadings filed in this action and the affidavit and exhibits of the original Defendant Third Party Plaintiff submitted in support of the Motion for Summary Judgment, and being of the opinion that no genuine issue as to any material fact has been shown to exist, and that the Plaintiff is entitled to a judgment for such amount as shall be found by the Court to be due him from the Third Party Defendant as damages. Further, the Court FINDS that the following specific facts exist in this action without controversy:

¹Presumably, the order was intended to be entered *nunc pro tunc* as of the date of the hearing, May 9, 1996, rather than as of May 9, 1995.

1. That the Third Party Defendant Robert W. Miller perpetrated an actual fraud against the Defendant Third Party Plaintiff Robert Twaddle;

2. That the Third Party Defendant Robert W. Miller used false representations to induce the Defendant Third Party Plaintiff Robert Twaddle to buy the Third Party Defendant Robert W. Miller's Wet Pets business;

3. That Robert W. Miller used a written statement that was materially false respecting the financial condition of the Wet Pets business, upon which the Defendant Third Party Plaintiff Robert Twaddle reasonably relied and which Robert W. Miller caused to be made or published with intent to deceive;

4. That the purchase agreement is hereby cancelled and set aside and the Defendant Third Party Plaintiff and the Third Party Defendant shall be returned to the status quo;

5. That the Defendant Third Party Plaintiff Robert Twaddle shall continue to operate the Wet Pets business until such time as this case shall come back before the Court for trial on the issue of damages.

It is further ordered that an interlocutory judgment be entered in favor of the Defendant Third Party Plaintiff Robert Twaddle against the Third Party Defendant Robert W. Miller, on all of the issues of this action relating to the liability of said Third Party Defendant to your Defendant Third Party Plaintiff and for such amount as may be found due to the Third Party Plaintiff as damages.

Upon a hearing on damages held July 15, 1996, the state court entered an order on July 16, 1996, awarding the plaintiff actual damages in the amount of \$166,279.00, together with postjudgment interest at 10% per annum, and granting the plaintiff a default judgment against the debtor for his failure to answer or otherwise appear in defense of the third-party

complaint. The debtor neither appealed that default judgment nor sought extraordinary relief from the state trial court.

In this adversary proceeding commenced November 1, 1996, the plaintiff seeks to except the judgment debt from discharge pursuant to 11 U.S.C. § 523(a)(2)(A) and (B), asserting that the debt arose out of the debtor's actual fraud, false pretenses, and false representations in connection with the sale of the business Wet Pets. The plaintiff alleges that the debtor, with the intent to deceive, misrepresented the dollar volume of the business, its income, and its accounts payable, that these misrepresentations were made both verbally and through "written financial information including tax schedules," and that the plaintiff relied on these representations in purchasing Wet Pets. The complaint further sets forth general allegations regarding the state court lawsuit and the resulting default judgment. In his answer to the complaint, the debtor denies "that he was guilty of any type of actual fraud, false pretenses, or misrepresentations," but otherwise admits the allegations as to the state court lawsuit and the existence of a judgment against him.

The plaintiff has now moved for summary judgment, asserting that the specific findings of the state court as set forth in its orders granting summary and default judgment are entitled to

collateral estoppel effect in this dischargeability proceeding. The response of the debtor is that collateral estoppel is not applicable because the state court judgment was not "actually litigated," a required component of collateral estoppel, in that the debtor "was unable to afford legal representation and was not in the area throughout most of [the state court] proceedings due to family illness." In addition, the debtor contends that the precise issues determined by the state court are not the same issues necessary for a finding of nondischargeability under 11 U.S.C. § 523.

II.

Fed. R. Civ. P. 56, as incorporated by Fed. R. Bankr. P. 7056, mandates the entry of summary judgment "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." Fed. R. Civ. P. 56. See also *Celotex Corp. v. Catrett*, 477 U.S. 317, 322, 106 S. Ct. 2548, 2554 (1986). In ruling on a motion for summary judgment, any inferences to be drawn from the underlying facts contained in the record must be viewed in the light most favorable to the party opposing the motion. See *McCafferty v.*

McCafferty (In re McCafferty), 96 F.3d 192, 195 (6th. Cir. 1996)(citing *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 587, 106 S. Ct. 1348, 1356 (1986)). Because the debtor has not disputed or otherwise challenged the validity of the state court summary judgment order or default judgment, the only determination for this court is whether plaintiff is entitled to a judgment of nondischargeability as a matter of law. The court has before it the pleadings filed by the parties in this adversary proceeding, certified copies of the plaintiff's state court motion for summary judgment and his affidavit in support thereof, and copies of the state court summary judgment order and default judgment.²

III.

In Rally Hill Prod., Inc. v. Bursack (In re Bursack), 65

²The copies of the state court summary judgment order and default judgment which are before the court are those which were attached to the motion for summary judgment and complaint filed by the plaintiff in this proceeding. These copies are not original certified copies, but are instead copies of formerly certified copies. Although these uncertified copies have not otherwise been properly submitted by affidavit, there has been no objection to the court's consideration of the copies for the purpose of ruling on the pending motion for summary judgment. Accordingly, any inadequacy as to their authenticity is deemed waived. See, e.g., 10A CHARLES ALAN WRIGHT, ARTHUR R. MILLER & MARY KAY KANE, FEDERAL PRACTICE AND PROCEDURE § 2722 n.38 (2d ed. 1983) and cases cited therein.

F.3d 51 (6th Cir. 1995), a 1995 decision of the Sixth Circuit Court of Appeals, the court held that as a general rule, the full faith and credit statute, 28 U.S.C. § 1738,³ obligates a bankruptcy court to give a state court judgment the same preclusive effect in bankruptcy dischargeability proceedings it would receive in the state where it was rendered. A question expressly left unanswered by *Bursack* was one that has divided not only the bankruptcy courts in this circuit but also those within the state of Tennessee: whether "any federal policy requires an exception to the normal operation of § 1738 in the case of a true default judgment." *Id.* at 54. This issue was resolved earlier this year by the Sixth Circuit Court of Appeals in *Calvert* with the court concluding that:

In the absence of any indication in the Bankruptcy Code or legislative history suggesting that Congress intended an exception to § 1738 apply to true default judgments and with no principled distinction between cases where a defendant participates in part in

³The U.S. Constitution's Full Faith and Credit Clause is implemented by the federal full faith and credit statute which reads in pertinent part as follows:

Such Acts, records and judicial proceedings or copies thereof, so authenticated, shall have the same full faith and credit in every court within the United States and its Territories and Possessions as they have by law or usage in the courts of such State, Territory or Possession from which they are taken.

28 U.S.C. § 1738.

defense of the state court suit and cases where the defendant does not respond at all, we conclude that collateral estoppel applies to true default judgments in bankruptcy dischargeability proceedings in those states which would give such judgments that effect.

In re Calvert, 105 F.3d at 322. In light of this clear and controlling precedent, the question necessary for resolution by this court is whether Tennessee courts would give plaintiff's state court default judgment against the debtor preclusive effect.

IV.

Under Tennessee law, "collateral estoppel bars relitigation of an issue if it was raised in an earlier case between the same parties, actually litigated, and necessary to the judgment of the earlier case." *In re Bursack*, 65 F.3d at 54 (citing *Massengill v. Scott*, 738 S.W.2d 629, 632 (Tenn. 1987)). The Sixth Circuit recognized in *Bursack*, which involved a Tennessee state court judgment, that even default judgments satisfy Tennessee's "actually litigated" requirement. *Id.* (citing *Lawhorn v. Wellford*, 168 S.W.2d 790, 792 (Tenn. 1943)) ("A judgment taken by default is conclusive by way of estoppel in respect to all such matters and facts as are well pleaded and properly raised, and material to the case made by declaration or other pleadings, and such issues cannot be relitigated in any

subsequent action between the parties and their privies.")).

The debtor's assertion that the default judgment rendered against him was not "actually litigated" because he was unable to afford legal representation and was not in this area during most of those proceedings does not foreclose the application of collateral estoppel. Upon service of the state court third-party complaint, the debtor was provided with an opportunity to defend the state court action, personally or through counsel. Therefore, his conscious decision not to make an appearance in the action for whatever reason does not mean that the pertinent issues were not actually litigated.⁴ Accordingly, the preclusive effect of plaintiff's state court judgment ultimately hinges on whether the issues to be determined in this dischargeability

⁴As noted by the bankruptcy court in *Harris v. Byard (In re Byard)*, 47 B.R. 700 (Bankr. M.D. Tenn 1985):

Collateral estoppel applies only to those issues which were "actually" or "fully litigated" in the prior action. However, this rule does not refer to the quality or quantity of argument or evidence addressed to an issue. It requires only two things: first, that the issue has been effectively raised in the prior action, either in the pleadings or through development of the evidence and argument at trial or on motion; and second, that the losing party has had "a fair opportunity procedurally, substantively, and evidentially" to contest the issue.

Id. at 707 n.9 (quoting *Overseas Motors, Inc. v. Import Motors Ltd., Inc.*, 375 F. Supp. 499, 516 (E.D. Mich. 1974), *aff'd*, 519 F.2d 119 (6th Cir. 1975)).

proceeding are the same as those raised in the state court action and necessary to its outcome.

An examination of the findings of the state court as set forth in the summary judgment order indicates that the issues which were raised therein and necessary to the conclusion that the debtor was guilty of fraud satisfy the elements required to deny dischargeability of a debt under 11 U.S.C. § 523(a)(2)(A), which excepts from discharge debts obtained by "false pretenses, a false representation, or actual fraud, other than by a statement respecting the debtor's or an insider's financial condition."⁵ As set forth in the summary judgment order, the Tennessee state court found, *inter alia*, that the debtor "perpetrated an actual fraud against the [plaintiff] ... [and] ... used false representations to induce the [plaintiff] to buy [debtor's] Wet Pets business." Because of this fraud, the state

⁵11 U.S.C. § 523(a)(2)(A) provides as follows:

A discharge under section 727 ... of this title does not discharge an individual debtor from any debt—

...

(2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained, by—

(A) false pretenses, a false representation, or actual fraud, other than by a statement respecting the debtor's or an insider's financial condition

....

court set aside the purchase agreement and subsequently granted plaintiff a judgment for actual damages in the amount of \$166,279.00.

In Tennessee, when a party intentionally misrepresents a material fact or produces a false impression in order to mislead another or to obtain an undue advantage over him, there is positive fraud. *Haynes v. Cumberland Builders, Inc.*, 546 S.W.2d 228, 232 (Tenn. App. 1976), *appeal after remand*, 565 S.W.2d 887 (Tenn. App. 1978)(citing *Rose v. Foutch*, 4 Tenn. App. 495 (1926)). In order to establish fraud under Tennessee law, it must be proven that (1) the defendant made a representation of an existing or past fact; (2) the representation was false; (3) the representation was in regard to a material fact; (4) the representation was made knowingly, or without belief in its truth, or recklessly; (5) the plaintiff reasonably relied on the representation; and (6) the plaintiff suffered damages as a result. See *Rally Hill Prod., Inc. v. Bursack (In re Bursack)*, 163 B.R. 302, 305 (Bankr. M.D. Tenn. 1994), *aff'd*, 65 F.3d 51 (6th Cir. 1995)(citing *Edwards v. Travelers Ins.*, 563 F.2d 105, 110-113 (6th Cir. 1977)); *Cumberland Builders*, 564 S.W.2d at 232. See also *Hiller v. Hailey*, 915 S.W.2d 800, 803 (Tenn. App. 1995), *appeal denied* (Tenn. 1995)(citing *Bevins v. Livesay*, 32 Tenn. App. 1, 221 S.W.2d 106 (1949)("The representation must be

in regard to a material fact, must be false and must be acted upon by the other party in ignorance of its falsity, and with a reasonable belief that it was not true.")). A finding of fraud by the state court necessarily includes a finding of all of these underlying elements. See 22 TENN. JUR. *Res Judicata* § 31 (1985)("It is not necessary to the conclusiveness of the former judgment that issue should have been taken upon the precise point which it is proposed to controvert in the collateral action, but it is sufficient if that point was essential to the former judgment.").

The essential components of fraud under Tennessee law are "virtually identical" to those necessary to establish nondischargeability under § 523(a)(2)(A).⁶ In *re Bursack*, 163 B.R. at 305. To obtain a determination of nondischargeability under this provision, a creditor must prove that (1) the debtor made materially false representations; (2) the debtor knew the representations were false at the time he made them; (3) the debtor made the false representations with the intention and

⁶The standard of proof is also the same. Compare *Grogan v. Garner*, 498 U.S. 279, 290, 111 S. Ct. 654, 661 (1991)(preponderance of the evidence) and *Hendrix v. Ins. Co. of North Am.*, 675 S.W.2d 476, 480 (Tenn. App. 1984)(preponderance of the evidence).

purpose of deceiving the creditor; (4) the creditor justifiably⁷ relied upon the debtor's materially false representations; and (5) the creditor sustained loss and damages as a proximate result of the materially false representation made by the debtor. *Id.* at 305. Because these elements were established by and necessary to the state court's finding of fraud, the principle of collateral estoppel bars this court from reconsidering these issues.

Notwithstanding the findings of the state court set forth in the summary judgment order and default judgment, the debtor urges the court to go behind the orders to evaluate the assertions underlying the state court's conclusions. The debtor argues that the summary judgment order "was carefully crafted to track the non-dischargeability language of section 523 even though those assertions were not completely raised in the pleadings and affidavits which were filed" and therefore "were

⁷Although the *Bursack* bankruptcy court in reciting the requisite elements which must be established under § 523(a)(2)(A) actually stated that "reasonable" reliance upon the materially false representation must be shown, the U.S. Supreme Court thereafter held that the standard of reliance that must be shown to except a debt resulting from fraud under § 523(a)(2)(A) is "justifiable" reliance and not the higher standard of "reasonable" reliance. *Field v. Mans*, ___ U.S. ___, ___, 116 S. Ct. 437, 444-46, 64 U.S.L.W. 4015 (1995), *on remand*, *Field v. Mans (In re Mans)*, 200 B.R. 293 (Bankr. D.N.H. 1996), *motion to amend denied*, 203 B.R. 355.

not actually determined by the state court." To support this argument, the debtor has submitted for the court's review the motion for summary judgment and supporting affidavit filed by the plaintiff in the state court action which was the basis of the state court's summary judgment order.⁸

Contrary to the debtor's assertion, this court is not persuaded from a review of the motion and affidavit that the findings in the judgment were not previously raised and thus not actually determined. The motion for summary judgment recites that the plaintiff "relied upon the representations of the Third Party Defendant Robert W. Miller that all accounts payable had been paid as of the closing date," that "after purchasing the Wet Pets business your Movant did discover that there were numerous accounts payable that had not been paid as of the date of closing and numerous judgments rendered against Robert W. Miller dba [sic] that remain unsatisfied," and that "the existence of said unpaid accounts and unsatisfied judgments constitute an intentional fraud perpetrated upon your Movant, and Movant would show that Robert W. Miller specifically

⁸The only portions of the state court record which were submitted for review by this court are the orders granting summary judgment and default judgment, plaintiff's motion for summary judgment, and his affidavit in support of the motion. The affidavit makes reference to certain attached exhibits but no exhibits were attached to the certified copy of the affidavit filed with this court.

intended to deceive your Movant, for the purpose of bringing about some financial gain to himself" The plaintiff's affidavit which accompanied the state court motion for default judgment states that "Robert W. Miller represented to me that he was on good standing with all of his creditors and I relied on said representations and the bill of sale and the representations contained therein in deciding to purchase the Wet Pets business" and that "[i]f I had known that the business owed these various debts I would not have purchased the business."

Clearly, these allegations substantiate the conclusions rendered in the summary judgment order: that the debtor knowingly misrepresented the outstanding debts of Wet Pets in order to deceive the plaintiff and induce him to purchase the business, that the misrepresentations were material in that plaintiff would not have purchased the business if he had known of the debts, and that the plaintiff relied on these representations and sustained damages as a result. Plainly, the thrust of both the motion and the affidavit were that the debtor perpetrated a fraud to induce the plaintiff to purchase his business and this was the conclusion reached by the state court.

The motion and affidavit are perhaps deficient in one respect in that they fail to allege that plaintiff's reliance on

the debtor's representations was "justified," a necessary element of nondischargeability under 523(a)(2)(A) or "reasonable", a required component of fraud under Tennessee law. *See Field*, ___ U.S. at ___, 116 S. Ct. at 444-446; *Cumberland Builders*, 564 S.W.2d at 232. This absence, however, is not fatal due to the fact that the state court would have had to conclude that the reliance by the plaintiff upon the false representations was reasonable in order to award summary judgment. *See* 22 TENN. JUR. *Res Judicata* § 31 (1985)("[E]very point which has been either expressly or by necessary implication, in issue, which must necessarily have been decided in order to support the judgment or decree, is concluded."). By meeting the more stringent "reasonable" reliance standard in the state court action, the lower "justifiable" standard required for dischargeability purposes under § 523(a)(2)(A) is satisfied. *See HSSM #7 L.P. v. Bilzerian (In re Bilzerian)*, 100 F.3d 886, 892 (11th Cir. 1997)(for collateral estoppel purposes, "justifiable" reliance element in § 523(a)(2)(A) action was satisfied by verdict of fraud from Texas state court jury that was required to utilize the higher standard of "reasonable" reliance); *Harris v. George (In re George)*, 205 B.R. 679, 681 (Bankr. D. Conn. 1997)(finding by state court of reasonable reliance satisfied justifiable reliance requirement of §

523(a)(2)(A)); *Kuzniar v. Keach (In re Keach)*, 204 B.R. 851, 854 n.2 (Bankr. D.R.I. 1996) ("Because the Plaintiff met her burden at the higher standard [of reasonable reliance in state court action], she would clearly satisfy the 'justifiable reliance' test to be applied [for collateral estoppel purposes in § 523(a)(2)(A) action]."). Accordingly, debtor's argument that the issues necessary for establishing fraud and resulting nondischargeability under § 523(a)(2)(A) were not established in the state court action is without merit.

V.

All three components of collateral estoppel under Tennessee law are established by the default judgment. No federal policy requires an exception to the normal operation of 28 U.S.C. § 1738 due to the default nature of the judgment. Therefore, this court must give preclusive effect to the state court default judgment⁹ and find that the plaintiff's default judgment entered

⁹The debtor asserts in his response that it would be unjust for the plaintiff to be granted a nondischargeable judgment for the full amount of the damages awarded by the state court since the plaintiff continued to operate the business after the state court rescinded the sale, thereby deriving economic benefit which should be offset against the judgment, and otherwise because the assets of the business were not returned to the debtor. Nonetheless, the amount of the debt determined by the state court is *res judicata*. See *Schaffer v. Dempster (In re Dempster)*, 182 B.R. 790, 799 (Bankr. N.D. Ill. 1995). Any
(continued...)

against the debtor collaterally estops him from contesting the nondischargeable nature of that judgment.¹⁰ An order granting the plaintiff's motion for summary judgment will be entered contemporaneously with the filing of this memorandum opinion.

FILED: May 30, 1997

BY THE COURT

MARCIA PHILLIPS PARSONS
UNITED STATES BANKRUPTCY JUDGE

⁹(...continued)
relief in this regard must be sought in the Chancery Court for Washington County, Tennessee.

¹⁰Because the court finds that the default judgment is nondischargeable under 11 U.S.C. § 523(a)(2)(A), it is not necessary to alternatively determine nondischargeability under § 523(a)(2)(B).

